should be included. Warehouse and dispatch expenditures may also be directly assignable to this category. A portion of technical overhead may be allocated, based on direct labor expenses or another reasonable basis. Expense items should not be double counted between this and other expense categories.

Appendix B

REPORT TO THE FEDERAL COMMUNICATIONS COMMISSION IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING TO IMPLEMENT RATE REGULATION SECTIONS OF THE CABLE TELEVISION CONSUMER PROTECTION AND COMPETITION ACT OF 1992

(FCC 92-544; MM Docket 92-266)

APPENDIX B: EVIDENCE OF THE MONOPOLY COMPONENT IN CABLE PRICES

January 27, 1993

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Appendix B

EVIDENCE OF THE MONOPOLY COMPONENT IN CABLE PRICES

1. Introduction

A principal objective of the Cable Television Consumer Protection and Competition Act of 1992 is to protect subscribers in areas with no effective competition from paying rates higher than those that would be charged if the system were subject to effective competition. Therefore, we believe that it would be useful for the Federal Communications Commission (Commission) to review evidence of the size of the monopoly component in basic and expanded basic rates prior to establishing its rules for rate regulation, in order to consider whether the various methods of rate regulation are likely to remove the monopoly component.

We present this brief overview of some of the evidence of the relative size of the monopoly to suggest how the Commission might further assess this issue before adopting its rate regulation rules to implement the Act. This evidence includes:

- Differences in pay and basic rate changes
- Cable system sales price trends
- "Franchise value" intangible assets
- Econometric studies
- Comparative rates in competitive or municipal systems
- Cost-of-service model results

Each type of evidence is briefly discussed below.

2. Differences in Pay and Basic Rate Changes

There have been several studies of the trends in cable television basic and expanded basic services rates over the past several years.[1] It is informative, however, to also consider trends

[1] For example, United States General Accounting Office, "1991 Survey of Cable Television Rates and Services," July 1991; GAO/RCED-91-195.

in pay services rates. Each pay service to some degree competes for subscriber dollars with other similar pay services (HBO and Showtime offer similar services, for example). Videocassette movies are also a possible substitute for pay services. Therefore, there may be some competitive pressure on pay rates from substitute products.

The graph appearing in Exhibit B-1 shows pay services rate trends in relation to trends in basic rates, and basic plus expanded basic rates, between 1984 and 1991. The figures are indexed to a base year of 1984, when the Cable Communications Policy Act was passed, deregulating rates in most jurisdictions (effective in January 1987). As the graph shows, the price of basic plus expanded basic nearly doubled in this time period, with pay rates remaining relatively constant.

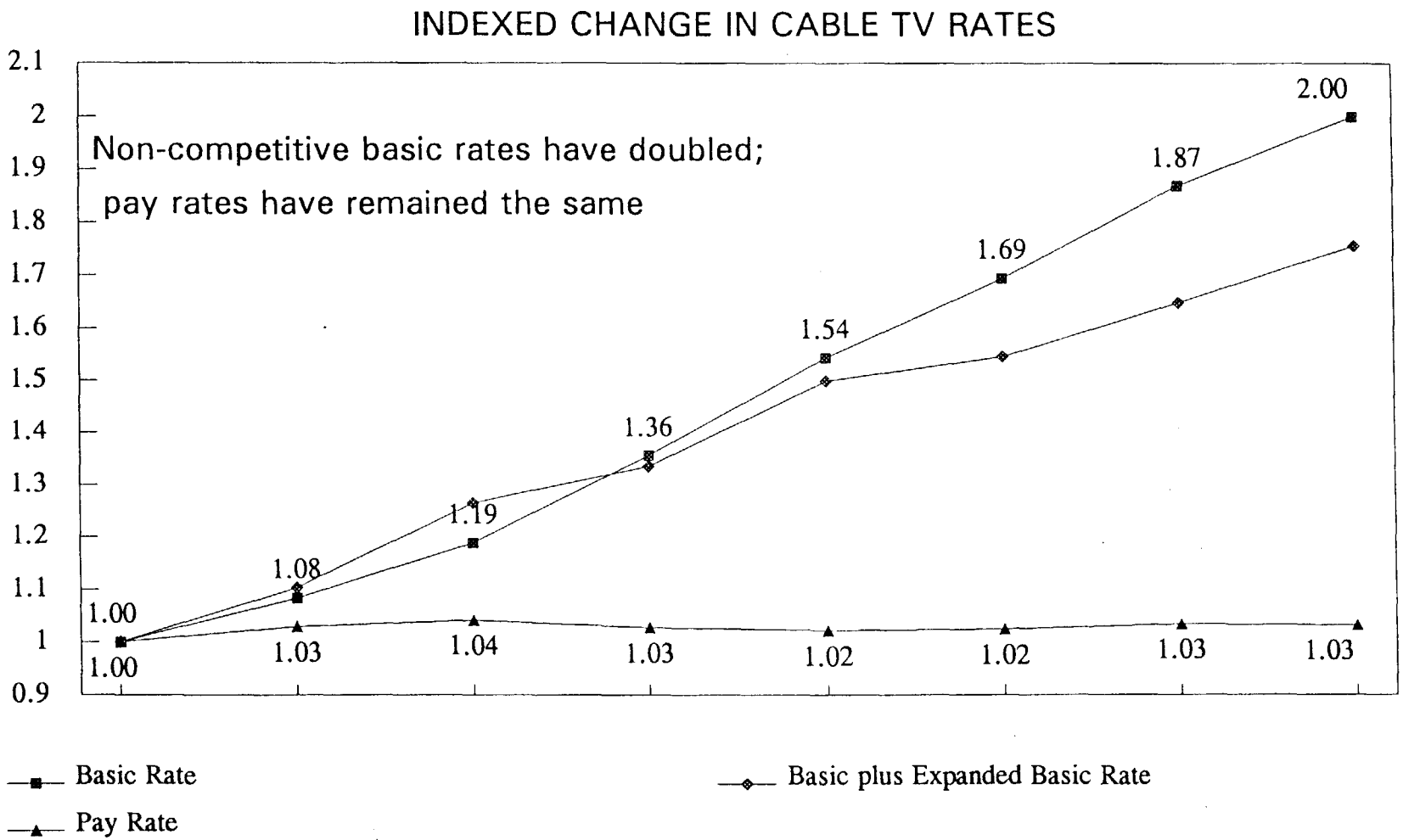
The possible reasons for the difference between the trends for pay versus basic/expanded basic services include:

- Differences in programming cost increases
- Differences in other cost increases
- Differences in the competitive situation of the respective services

The costs of obtaining programming differ between pay and the basic/expanded basic tiers, but the different services share the same joint and common costs. While possible differences in program acquisition cost changes between pay and basic/expanded basic services may explain some of the difference in rate trends, it is unlikely that such a large variation can be explained by programming costs -- programming costs for basic plus expanded basic typically represent no more than 10% to 20% of the related revenues. And since the joint and common cost pool is the same, changes in these costs also cannot explain the differences in trends. Therefore, it appears that the non-competitive nature of basic/expanded services, versus the more competitive environment of pay services, seems to explain much of the difference.

If a competition standard were used as the basis for indexing allowable rate adjustments, and changes in pay rates were used as the data points for what could be expected in a competitive environment, then basic/expanded basic rates would be held to approximately what they were in 1984.

Exhibit B-1



Data source: "The Cable TV Financial Databook," Paul Kagan Associates, Inc., 1984-1992

Appendix B

3. Cable System Sales Price Trends

Exhibit B-2 illustrates that sales prices for cable systems, when expressed on a per subscriber basis, have nearly doubled since 1984. The reasons this value may have changed include:

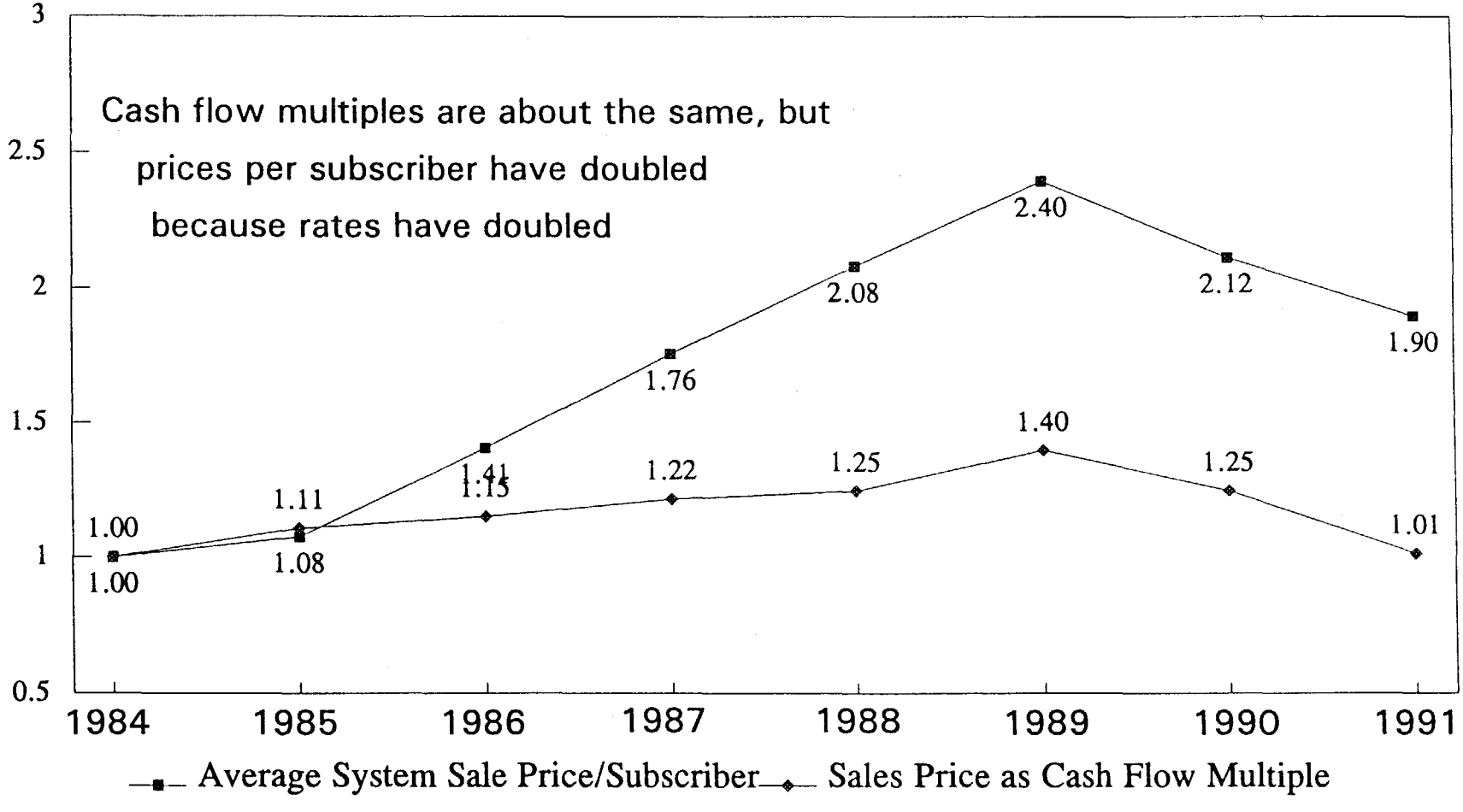
- Changes in the cost of capital and/or expected future growth rates

- Additions of revenue sources
- Increases in rates exceeding increases in cost per subscriber

Changes in the cost of capital, in combination with expected future growth rates, would be reflected in the cash flow multiples paid for acquired systems. Since the average multiple was the same in 1991 as it was in 1984, this factor cannot explain the per subscriber value change.

Exhibit B-2

INDEXED CHANGE IN CABLE SYSTEM SALES VALUES



Data source: "The Cable TV Financial Databook," Paul Kagan Associates, Inc., 1984-1992

Some of the increase in values is likely explained by additions of revenue sources. Non-subscriber revenues, such as advertising and home shopping, increased during the 1984 to 1991 period, and as system channel capacity increased more programming services could be carried. However, these factors do not appear to be sufficient to explain the magnitude of the increase in sales values.

That leaves actual rate increases, in excess of any cost per subscriber increases, as the most significant explanatory factor for the majority of the increase. Rate increases exceeding subscriber cost increases mean higher cash flows, thus increasing what a buyer will pay for a system. The data seem to support a hypothesis that one notable effect of rate de-regulation was to increase the price buyers were willing to pay to acquire cable systems because they expected and were able to achieve higher rates (and therefore higher cash flows) than they did when most local franchise authorities could regulate basic rates.

4. "Franchise Value" Intangible Assets

The expectations a buyer may have for supernormal profits attributable to rates above those necessary to provide a normal cost of capital are captured as intangible "franchise value" when a system is sold.[2] Intangible assets result from accounting transactions to reconcile the cost of a system acquisition with the current tangible value of that system. Typically the tangible assets are valued at current market prices or depreciated replacement costs, and the difference between the purchase price and the tangible asset values are assigned to intangibles. Most of the intangible value in a cable system following a sale is represented by the "franchise value."

In fact, intangible assets are now a much higher proportion of cable company assets than they were in 1984, as shown on a company-wide basis for certain multiple system operators in Exhibit B-3. Most of this increase is likely attributable to the "franchise value" associated with acquisitions of cable systems.[3]

The difference in the sales value of cable systems and the replacement value of the tangible assets can be used to generate a measure of the monopoly power of the industry. This measure, Tobin's q, has been addressed in several submissions in previous Commission proceedings, so

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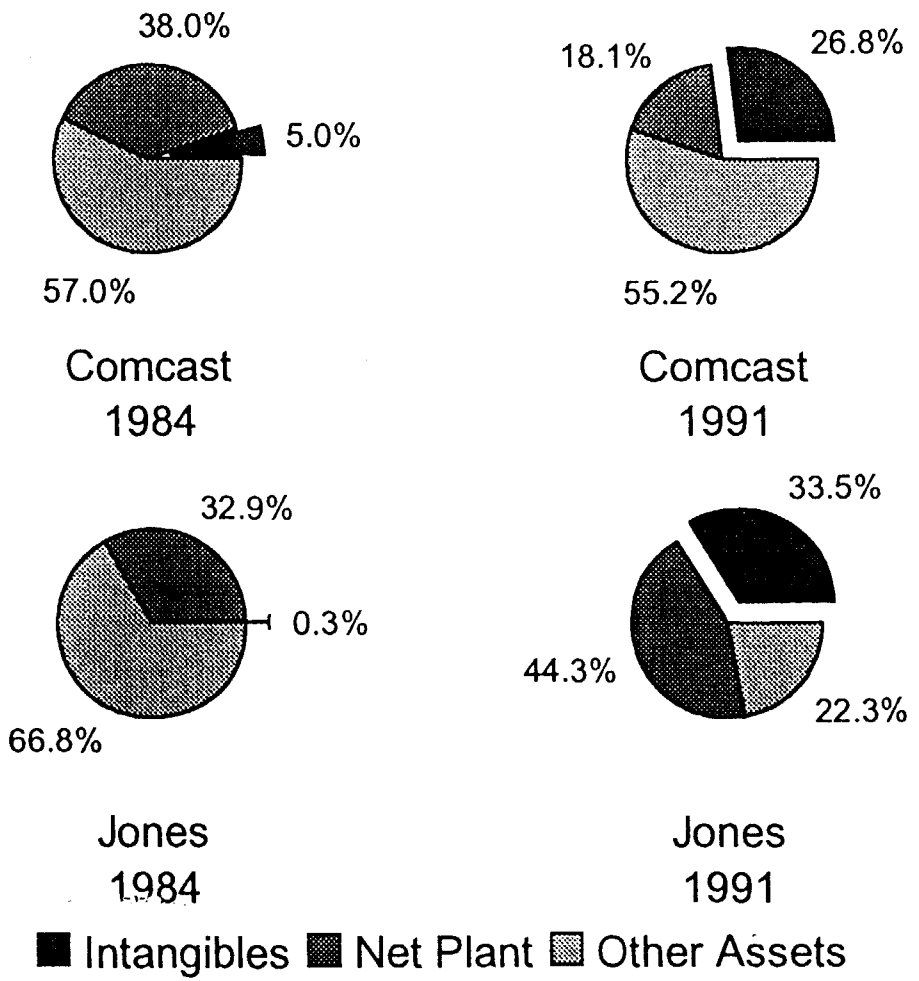
[2] An extensive discussion of "franchise value" in the cable television industry appears in the record of United States Tax Court, Docket No. 268-89 (Filed November 7, 1990). Tele-Communications, Inc. and Subsidiaries v. Commissioner of Internal Revenue. 95 T.C. No. 36.

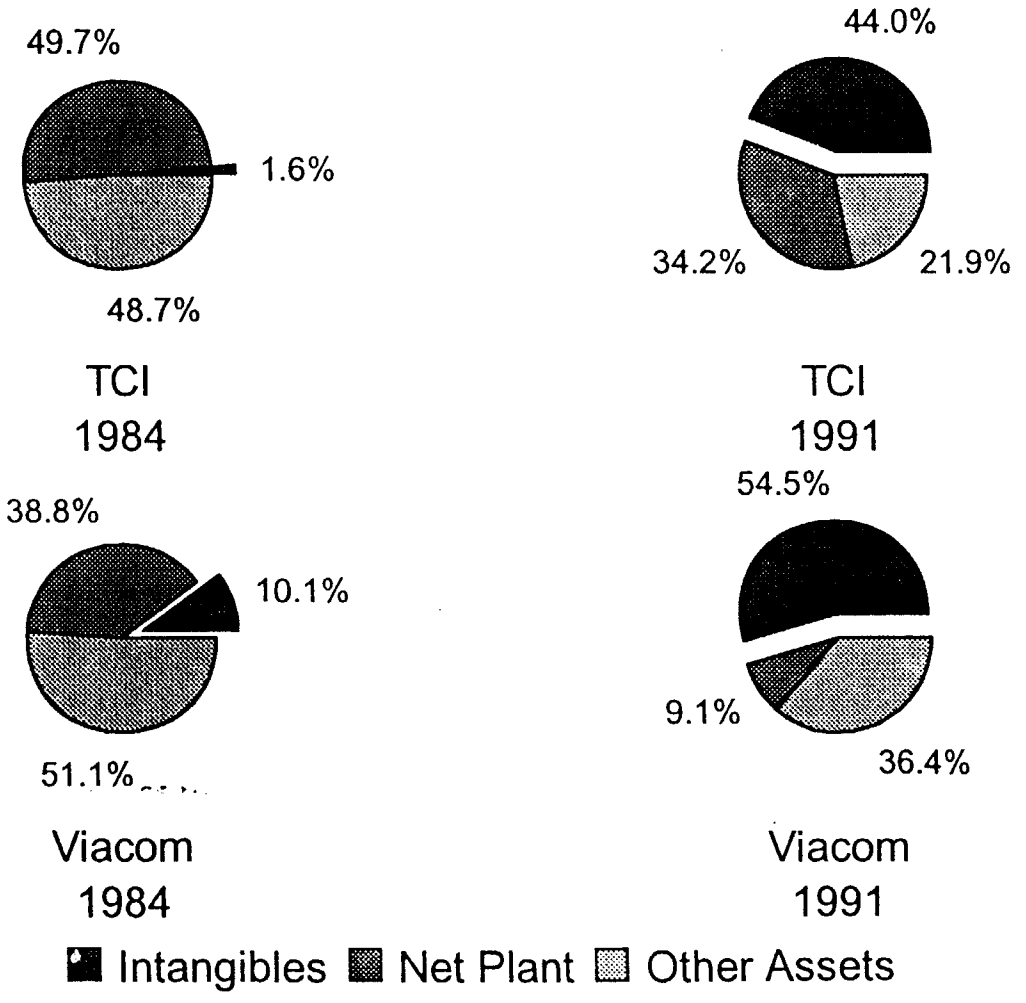
[3] Although other local cable system intangibles and intangibles from other lines of business likely compose some of the intangible component as well.

INTANGIBLES ARE NOW A MUCH HIGHER PROPORTION OF CABLE COMPANY ASSETS



Data source: "The Cable TV Financial Databook," Paul Kagan Associates, Inc., June 1992

INTANGIBLES ARE NOW A MUCH HIGHER PROPORTION OF CABLE COMPANY ASSETS



Data source: "The Cable TV Financial Databook," Paul Kagan Associates, Inc., June 1992

we do not include a discussion here. We note, however, that while the Tobin's q's calculated for cable by various analysts differ, the results indicate that local cable systems have considerable market power in relation to firms in a competitive industry.

The size of the monopoly "franchise value" was directly addressed in a U.S. Tax Court case involving Tele-Communications, Inc. (TCI).[4] For three specific TCI systems the court found that 39% of the sales price was attributable to intangible "franchise value." The systems involved in this case sold well before 1984, when sales prices began to rise substantially. Generally one would expect to find "franchise value" to be an even higher proportion of the sales price for transactions occurring since rates were deregulated in most communities.

One way to apply "franchise value" figures to estimate the size of the monopoly component of rates is to assess what rates would be required to produce a reasonable return excluding the monopoly "franchise value," versus those required to produce a return on this intangible in addition to on the tangible assets. This could be done for specific systems where sufficient accounting data are available to perform a simple utility cost-of-service analysis, looking particularly at systems that sold between the passage of the Cable Communications Policy Act of 1984 and 1992 Act.

We have applied an industry average approach to use intangible franchise value to estimate the size of the monopoly component in Exhibit B-4. The result indicates that the monopoly component was in the range of 28% to 49% for the most popular basic service tier in 1991.

5. Econometric Studies

There is a large body of literature on the monopoly characteristics of cable television, including numerous econometric studies. One of the more recent studies develops a measure of how much of the cable television price increase since deregulation is due to monopoly power. We quote the abstract of this U.S. Department of Justice study:[5]

Since the deregulation of rates for basic cable television service, increases in prices have outpaced the rate of inflation.... [A]t least 45-50% of the price increase...is due to market power.

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[4] Tele-Communications, Inc. and Subsidiaries v. Commissioner of Internal Revenue. 95 T.C. No. 36. Supra.

[5] Robert Rubinovitz, "Market Power and Price Increases for Basic Cable Service Since Deregulation," U.S. Department of Justice, Antitrust Division, Economic Analysis Group (August 6, 1991).

Exhibit B-4

METHOD TO ESTIMATE THE SIZE OF THE MONOPOLY COMPONENT OF BASIC RATES BY ADJUSTING FOR INTANGIBLE "FRANCHISE VALUE"

	Upper End of Range	Lower End of Range
Average system sales value 1991[1]	$ 1,850	$ 1,850
Range of average cost per subscriber to build a modern cable system[2]	$ 700	$ 1,200
Difference (intangible "franchise value")	$ 1150	$ 650
Return on capital on the difference (assume 12%)[3]	$ 138	$ 78
Assume 80% attributable to basic and expanded basic[4]	$ 110	$ 62
Monthly size of the monopoly component (surplus return divided by 12)	**$ 9.20**	**$ 5.20**
Estimated percent of the monopoly component, 1991[5]	**49%**	**28%**

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1 The approximate average of 1991 sales, reported in "The Cable TV Financial Databook," 1992; Paul Kagan Associates, Inc.; Carmel, California.

2 Assumed values; the actual figure could be empirically determined by the Commission.

3 Assumed weighted debt/equity return.

4 Based on assumed distribution of channel capacity.

5 Monopoly component divided by $18.84 (the 1991 average for the most popular basic service, as reported by the General Accounting Office)

Appendix B

6. Comparative Rates in Competitive or Municipal Systems

The Commission suggests that rates in areas with effective competition or where the franchising authority is itself the cable operator may be one way to benchmark rates. We see certain limitations in this approach, but we nevertheless believe it can provide a useful guide to the order of magnitude of the monopoly component now contained in rates where there is no effective competition. We surveyed several such systems between January 14 - 22, 1993. The results of the survey are shown in Exhibit B-5 for systems that report that they are in competition, and in Exhibit B-6 for municipal systems. We cannot be certain that all systems reported are actively competing.

Exhibit B-5

CABLE SYSTEMS IN COMPETITION*

State	City/County	Operator	Number of Subscribers	Homes Passed	Plant Miles	Basic Rate	# of Basic Channels	Basic Rate/ Channel	Expanded Basic Rate	# of Exp. Basic Chan.	Exp. Basic Rate/Chan.	Converter	Installation
Arkansas	Paragould	Paragould City Light & Water	3,600	9,000	130				$13.63	48	$0.28	$0.00	$0.00
Arkansas	Paragould	Paragould Cablevision	5,770	6,329	104				$12.19	44	$0.28	$0.00	$0.00
Alabama	Troy	Troy Cablevision	1,987	n/a	n/a				$14.00	52	$0.27	$2.00	$0.00
Alabama	Troy	Storer Cable Communications	3,503	6,588	n/a	$8.10	32	$0.25	$9.95	67	$0.15	$0.00	$9.95
Arizona	Mesa	Cable America Corp.	7,290	4,950	70	$8.03	20	$0.40	$18.13	55	$0.33	$0.00	$15.95
Arizona	Mesa	Dimension	n/a	n/a	n/a							n/a	n/a
Florida	Orange County	Telesat	n/a	n/a	n/a				$19.93	54	$0.37	$0.00	$0.00
Florida	Orange County	Cablevision Industries	5,400	n/a	n/a				$15.05	46	$0.33	$0.00	$9.95
Georgia	Vidalia	TCI Cablevision of Georgia	3,707	n/a	n/a	$10.95	24	$0.46	$13.45	30	$0.45	$0.00	$0.00
Georgia	Vidalia	Southland Cablevision, Inc.	2,419	5,000	100	$10.95	13	$0.84	$15.75	43	$0.37	$0.00	$0.00
Kentucky	Glasgow	Glasgow Electric Plant Board	1,500	5,000	90				$13.95	48	$0.29	$0.00	$0.00
Kentucky	Glasgow	TeleScripps Cable Co.	5,180	6,065	119	$8.95	18	$0.50	$12.50	48	$0.26	$0.00	$0.00
Michigan	Negaunee	City of Negaunee Cable TV	1,370	1,600	27				$10.95	32	$0.34	$0.00	12
Michigan	Negaunee	Bresnan Communications	18,808	21,331	358	$18	30	$0.59	$19.95	35	$0.57	$2.00	$40.00
New Jersey	Paramus	Cablevision Systems Corp.	47,080	n/a	n/a				$22.95	25	$0.92	$0.00	$0.00
New Jersey	Paramus	United Artists Cable of N.J.	186,632	n/a	n/a				$22.30	29	$0.77	$0.00	$63.60
Pennsylvania	Allentown	Service Electric Cable TV	82,000	145,000	2,100				$21.00	56	$0.38	$0.00	$0.00
Pennsylvania	Allentown	Twin County Cable	55,000	110,000	2,600				$20.50	59	$0.35	$0.00	$25.00
Pennsylvania	Pottsville	Warner Cable of Pottsville	n/a	n/a	n/a	$11.00	14	$0.79	$18.74	39	$0.48	$0.00	$40.00
Pennsylvania	Pottsville	Wire Tele-View	1,625	3,750	16				$14.00	26	$0.54	$0.00	$30.00
					Averages:	**$9.47**	**21.6**	**$0.55**	**$16.26**	**44.0**	**$0.41**	**$0.20**	**$12.32**

* Some of these systems may not meet the Cable Act effective competition test of passing at least 50% of the homes in the specified community.

Rates and channels source: Telephone calls to the respective operators, January 14 - 22, 1993

System statistics source: Television and Cable Factbook, 1992

Exhibit B-6

MUNICIPAL CABLE SYSTEMS

State	City/County	Operator	Number of Subscribers	Homes Passed	Plant Miles	Basic Rate*	# of Basic Channels*	Basic Rate/ Channel*	Expanded Basic Rate	# of Exp. Basic Chan.	Exp. Basic Rate/Chan.	Converter	Installation
Arksansas	Opp	Opp Cablevision	3,199	3,500	125				$14.00	30	$0.47	$5.00	$15.00
Arkansas	Conway	Conway Corp.	10,355	n/a	n/a				$11.66	23	$0.51	$0.00	$25.00
California	San Bruno	City of San Bruno	11,161	15,000	73				$19.95	44	$0.45	$0.00	$30.00
Georgia	Covington	City of Covington	5,128	9,300	n/a				$15.00	29	$0.52	$0.00	$35.00
Georgia	Monroe	City of Monroe W,L&G Com.	4,178	4,500	95				$10.00	30	$0.33	$0.00	$0.00
Kentucky	Bardstown	City of Bardstown	3,998	7,500	150				$13.39	31	$0.43	$3.50	$20.00
Kentucky	Frankfort	Frankfort E&W Plant Board	11,336	14,000	220				$9.70	37	$0.26	$1.00	$5.00
Michigan	Lowell	Lowell Cable TV	1,875	2,365	40				$17.55	23	$0.76	$2.00	$20.00
Michigan	Wyandotte	Wyandotte Municipal Services	9,004	13,000	70				$12.00	47	$0.26	$0.00	$20.00
								Average:	$13.69	32.7	$0.44	$1.28	$18.89

Rates and channels source: Telephone calls to the respective cable operators, January 14 - 22, 1993

System statistics source: Television and Cable Factbook, 1992

* Too few of these systems offered more than one basic service tier

Appendix B

We compared the expanded basic (most popular tier) average rates per channel to the General Accounting Office (GAO) national survey findings for a broad sample of systems (mostly areas where there is no effective competition and no municipal system) as of April, 1991:

	Rate per Channel Most Popular Tier	Percent Less Than 1991 GAO
GAO cross-section survey result, April 1991	$ 0.54	N/A
January 1993 survey, competitive systems	$ 0.41	24.1%
January 1993 survey, municipal systems	$ 0.44	18.5%

The 1993 competitive system and municipal rates were notably less than even the 1991 rates (nearly two years old) for the cross section of systems.[6]

We encourage the Commission to analyze the rate survey results it receives in January (if there are sufficient data) in the manner we have here, as it seeks to estimate the size of the average rate decrease necessary to assure that subscribers in non-competitive areas pay no more than those in areas where there is effective competition.[7]

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[6] If rates were cost based and did not include a monopoly component, theoretically one would expect rates to be even lower than they are where there has been sustained competition. Because competitive systems duplicate plant and split the subscriber base, they do not enjoy the same economies of scale as if there were only one operator in the community. This means that their average cost per subscriber is higher than it would be for a de facto monopolist. Consequently, one would expect truly cost based rates in the communities served by a single operator to be even lower than those found in the competitive communities in the long run.

[7] In analyzing the rate data obtained for supposed "effective competition" areas, the Commission should assure that each respective area meets the tests specified in the Act to define competition. We have found for example, that many supposedly competing cable systems overlap only in small areas, and at least one of the systems in each case would not meet the test of passing at least half of the homes in the franchise area and/or actually serving at least 15% of the franchise area.

Appendix B

7. Cost-of-Service Model Results

We have recommended a cost-of-service benchmark model to determine reasonable basic and expanded basic rates (see Appendix A). We applied this model to evaluate data for certain cable systems. However, instead of applying national norms (which we believe the Commission should develop) in the model, we adjusted the model for each system we analyzed to assure that the model reflected the full operating costs and the full capital expenditure (valued at original cost) for the particular system. We were able to do this for several systems because we obtained local system financial statements filed with the several franchise authorities, and also obtained the subscriber, plant mile, and channel line-up information necessary to apply the model.

We stress that the results we obtained are based on the full actual reported costs of the systems we analyzed, so the nature of our findings cannot be attributable to any under-estimates of the applicable costs.[8]

The results of this analysis of 13 systems are shown in Exhibit B-7. Depending on whether a simple average or a subscriber-weighted average of the findings is applied, we estimated that if basic tier rates were based on actual costs, they would be only about 46% to 63% of what they actually are in these systems; expanded basic rates would be about 72% to 85% of what they actually are.[9] In only one case did we estimate a cost-based rate higher than the actual rate (for expanded basic for one system. In every other case the cost-based estimate was lower than the actual rate, generally by a large margin.

One of the reasons, among others, that the costs of the low basic tier varied as widely as shown (from $1.50 per month to $12.60 per month) is the variation in the programming that is offered on that tier. When no satellite signals or distant broadcast signals are carried on the low tier,

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[8] We did make assumptions about certain factors that affect the allocation of costs to specific tiers of service. We selected these assumptions in a conservative manner so that we would not understate the cost-based basic and expanded basic rates. Therefore, if our estimates of the cost-based rates err, they likely err on the high side.

[9] We did not select these systems randomly. The represent those for which we received sufficient data from franchise authorities to enable us to perform the analysis. We did not reject any system because of results; the thirteen systems shown are simply those for which we had enough data at the time our analysis was performed. If anything, these systems likely over-represent large urban systems, where average costs (and therefore cost-based rates) are likely to be higher than the overall national average.

there may be essentially no direct programming costs, only allocable joint and common costs and revenue based costs.

This finding is interesting in light of the announced plans of certain multiple system operators, including Tele-Communications, Inc., that they will begin to offer lower priced re-tiered basic in many systems within the next several months. Many of the re-tiering plans we have seen would provide a package of local broadcast stations, PEG channels, local origination, bulletin boards, and advertising for the system's pay services on the lowest tier. No satellite services would be on the lowest tier (a tiering reality already in many communities). Based on the data we have assessed, we believe the true cost-based rate for these stripped-down services should more likely be in the range of $1.50 to $5.00 per month (depending on joint and common cost allocations in the specific system), rather than the $10 to $11 range being announced by some operators.

ANDREWS OFFICE PRODUCTS CAPITOL HEIGHTS, MD (K)

APPENDIX 2
ESTABLISHMENT OF INTERIM RATE

For reasons suggested in the main comments, cable rates now are too high and subscribers require immediate relief. The Coalition asks the Commission to adopt an interim benchmark rate per channel that would be used as a guide by municipalities in setting rates while the Commission takes the steps necessary to establish a set of cost-based industry norms that can be used to derive rates at the local level.

The Coalition recommends an interim per channel rate based on an examination of a number of factors that, as applied below, includes rough surrogates for cable industry costs. Because the Coalition also proposes a procedure for review of the rates at the local level that should allow for adjustments should the rate prove too high or too low, the operator and the public are protected. The recommended rate is not designed to be applied over time, and is, in fact, designed as a temporary measure, to guide localities in establishing basic rates (and the Commission in establishing expanded basic rates) while a cost-based method of establishing rates is implemented. Over time, significant problems can develop if per channel rates are applied blindly. Because the cost of activating channels is quite low, per channel costs actually reduce over time. Per channel costs were higher in 1984 than they were in 1992, see Statement of Senator Danforth, Cong. Rec. 1/27/92 at 5413. Over time, it would be necessary to reduce per channel rates

by a productivity factor.[1] Similarly, allowing an increase in price equal to the per channel charge for each channel added would lead to abuses. An operator who increases rates by an amount per channel could increase profits by activating so-called "barker" or videotext channels or other no-cost services on basic and expanded basic or by eliminating programming altogether. These evasions can be stopped by localities in the short term (and the Commission can help by making it clear that communities may adjust rates to prevent such abuses), but in the longer term, a more cost-based rate method appears necessary.

The per channel cost derived below was, to the extent possible, derived by comparing current costs and rates for systems. It identifies the magnitude of the reduction required to provide consumers the immediate rate relief Congress intends. The approach is comparable to calculating a percentage reduction in current rates, based on a calculated monopoly profit component.

The Coalition believes that the per channel rate for basic and expanded basic service should not exceed $0.32/channel. It calculates this rate examining the following:

1. An estimate of the appropriate rate for service in select communities, based on costs reported by the operators to those communities. The rates were estimated by Jay Smith and Michael Katz, and are set forth in Appendix B, Attachment B-7 ("Smith & Katz, App. B"). Five of the thirteen systems examined had per

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[1] If new channels are added, the cost per channel in a given community should go down.

channel rates of between $0.20 - .29 cents, four had rates between $0.30 - .39, three had rates between $0.40 - .43 cents, and one had a rate over $0.70 per channel. The $0.70 rate is clearly unrepresentative and would lead to substantial overrecoveries of rates in most communities. That rate was therefore ignored. A rate between $0.32 and $0.39 seems most typical. However, the rates in the $0.23 - .32 range were particularly notable for two reasons: (1) the systems analyzed tended to be larger, more modern systems; rates are likely to be even less per channel on a cost basis in older systems where plant may be fully depreciated, and services (and programming costs) may be extremely limited; and (2) the data suggests that at a $0.23 - .32 rate, operators can provide significant services, profitably. Hence, there is every reason to suppose the lower-end rates are more representative of reasonable rates.

2. An examination of rates where there is head to head competition. The survey is set forth in Smith & Katz, App. B, Exhibit B-5. As Smith & Katz point out, the data must be approached carefully. There are several reasons why, in a particular community, apparent head-to-head competition may not lead to lower prices: In Orange County, for example, Cablevision Industries has agreed to purchase the Telesat system; Telesat no longer has any incentive to cut prices to its customers pending the resolution of that sale. In 1986, when it first surveyed the Orange County system, Telesat's rates was $11.95, $2.00 below the Cablevision rate for the market; now Telesat charges $19.93 for

virtually the same service, almost $5.00 above the Cablevision rate. Similarly, in Negaunee, Michigan, the privately-owned system raised prices significantly after reaching a litigation settlement with the City. Nonetheless, the data are instructive. The rate per channel was between $0.26 - .30 in two communities -- Paragould, Arkansas and Glasgow, Kentucky -- where there is active competition. The majority of competing systems charged $0.35 or less per channel. Taking this into account and discounting systems where competition does not appear to be active suggests that a reasonable rate might be approximately $0.26 - .35 per channel.

3. An examination of rates for municipal systems. Municipal systems typically price services in one of two ways: first, to keep rates as low as possible while covering costs and returning a relatively lower amount to the general fund; or second, to match rates charged by private systems, and to return the excess profits to the community. For such systems, the per channel rate may actually be closer to industry norms than competitive prices. Smith & Katz surveyed nine municipal channels and found that the rates they charged varied from $0.26 -.76 per channel. Given the limited data, these figures may be more useful as a check on the forgoing than anything else.

4. Other indicators. A U.S. Department of Justice study estimated that 45-50 per cent of all rate increases since 1984 were attributable to the market power of cable operators. Average cable rates are now in the $18-$22 range; they were approximately $9.00 in 1984. If the Department of Justice is correct, rates for basic

and expanded basic service should total $13.50-$15.50 ($0.21 - $0.37 per channel for a 48-channel service). That conclusion is consistent with Smith & Katz, App. B. Exhibit B-7, estimating that on average consumers are entitled to 30 per cent reductions in rates, 40-55 per cent in most communities. See also Exh. B-1 (comparing indexed changes in pay and basic cable rates); Exh. B-4 (estimating a 28% - 49% monopoly rate component based on an examination of intangible values).

Conclusion. The data, properly applied, points in one direction: rates for basic and for expanded basic are too high -- substantially too high. There are very good policy reasons to set the rate toward a $0.21 per channel rate, to maximize elimination of monopoly profits. However, considering the high and low ranges described above, the Commission should rule that a community may require operators to charge no more than $0.32 per channel for basic service, and rule that a rate for expanded basic exceeding $0.32 per channel, or a combined rate for basic and expanded basic of more than $0.32 per channel, would be considered presumptively unreasonable, were a complaint to be filed with the Commission. This leaves rates for private cable systems well-above rates for municipalities and in the most competitive cable markets, and well within range of rates calculated on a cost basis.

The Commission can reach this result consistent with its obligations under the Cable Act. The general conclusion, that rates are too high, accords with the conclusion of Congress. More specifically, the recommended rate is based on a direct or implicit

consideration of factors that the Commission must consider in determining whether an expanded basic rate is unreasonable.[2] As applied to the basic rate component, the number almost certainly overestimates the nominal cost of providing basic, particularly considering that basic programming costs may be quite low, but under the Coalition's proposal the locality could, after hearing, reduce the basic rate to more clearly reflect competitive levels in light of the services actually offered. In the meantime, adopting the rate should afford almost all consumers an opportunity for immediate rate relief.

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[2] The analysis considered the rates charged by systems, less the identifiable monopoly component; historical changes in rates, as analyzed in relation to pay rates and growth in intangible system values by Smith & Katz; rates for systems facing competition; basic and expanded basic rates as a whole for the system; and costs and revenues. To the extent other matters are not considered with respect to expanded basic rates -- the cost for equipment, for example -- they could be considered at the time a complaint is filed, as necessary.